A Strategy for Risk

Regular dialog about threats helps incorporate their management into CUs’ cultures and long-range planning.

By Keith Loria

Sound risk management is crucial to the ongoing success of any credit union—and today’s world is certainly risky. So it’s no surprise that boards and executives are regularly discussing the threats.

At $1.5 billion Elevations Credit Union (www.elevationscu.com), Boulder, Co., risk is talked about daily, says Darlene Brown, VP/corporate risk. After all, she notes, risk is at the core of the credit union business model.

“At the board level, the measurement is part of our culture,” she elaborates. “We measure it, monitor it, mitigate it and report on it. At the board level, the measurement is part of our key performance indicators, (both) in summary and by three key areas—operational, credit, and market risk.

“Board policy sets an appetite, reporting guidelines and expectations. A risk oversight committee monitors the metrics and emerging threats, and makes decisions on mitigation. The rest of the organization mitigates threats. Managing risk functions better when everyone takes ownership.”

Jon Bruflat, AVP/enterprise risk management for $1.4 billion Vantage West Credit Union (www.vantagewest.org), Tucson, Ariz., identifies risk management as part of his CU’s culture and day-to-day activities. In fact, risk gets talked about so much that people don’t give much thought to the discipline of “risk management” because they are already doing it.

“The key to building a risk management culture is to create a common language related to risk and to make time to talk about risks,” he says. “With these discussions and some additional formal effort, the employees and the board become more aware of risk and begin to think about risks. This will have an impact by shifting focus toward potential risks and asking questions related to what risks the organization faces.”

To make sure their credit unions have a handle on key risk areas (the National Credit Union Administration defines seven, see cues.org/ncua7), boards can do three things, says Vincent Hui, senior director at CUES Supplier member and strategic provider Cornerstone Advisors Inc. (www.crnrstone.com), Scottsdale, Ariz.

“The first is to really provide some specific risk appetite statements,” he says. “The second is to talk about what happens if events you can’t anticipate actually occur. “The third thing is to start thinking about risk scenarios and how you track results. “‘Results’ mean two broad groups: The first are the trigger events/thresholds that you should monitor for higher risk scenarios; the second relate to what needs to be measured/monitored when a risk scenario approaches or occurs—things like...
Steps Toward Strategic ERM

Guidance issued by the Treadway Commission’s Committee of Sponsoring Organizations (www.coso.org, a joint initiative of five organizations, including the American Institute of Certified Public Accountants), applies enterprise risk management to four areas of an organization: strategy, operations, reporting, and compliance.

“In the beginning, the efforts of our ERM department were largely related to reporting and compliance, i.e., fixing things, addressing examiner and auditor comments,” Bruflat says. “You could argue that is process improvement and you are hopefully making things more efficient along the way, but that is not addressing the larger risks the organization faces from a strategic standpoint. You are fighting fires, not managing the forest.”

To move its program along the curve, Vantage West CU formed a risk oversight committee and holds formal discussions quarterly.

“The goal of these discussions is to get management and the board on the same page regarding risks and opportunities, and to understand context for the efforts going on throughout the credit union,” Bruflat says. “We are currently shifting our focus away from reporting and compliance and moving toward operations and strategic.”
“Scenario planning should be considered to forecast potential future environments and how the board would change its strategy if faced with that environment.” — Darlene Brown

To build risk management into long-range planning, it’s important to ask probing questions about the strategic plan, Bruflat says. This is not necessarily to poke holes in it, but to make sure the plan is realistic, and that the goals and metrics used to gauge the plan’s success are informed measurements.

“If you want to be No. 1 in your local market, you need to first know what number you are now, and who is ahead of you,” he says. “What is the measured gap and how do you plan to bridge that gap? These plans become projects and steps toward the longer-term goals of the organization, and lay a path toward future success.”

According to Brown, a key way to tie together risk and long-range planning is to make sure your strategy session includes discussion of emerging threats to the strategy itself.

“At least annually, this topic should be assessed and addressed,” she notes. “Additionally, after the creative work is done and vision is cast, an assessment of threats should be part of the decision-making process.

“Finally,” she adds, “scenario planning should be considered to forecast potential future environments and how the board would change its strategy if faced with that environment—not a response plan, but a vision of who the credit union would be in that world.”

Consider These Real Risks
A key type of risk that a credit union board is concerned with is reputation risk. “Reputation risk in a traditional sense is making sure you are in the press for the right reasons and not the wrong reasons,” Bruflat says. But boards have to be even savvier these days because social media has changed reputation risk management.

It used to only matter that a credit union respond appropriately to a member concern, so the members’ friends and family members would still hear good things about the credit union from the affected member. Now, social media may well headline opinions in a public forum about how a credit union has handled the member’s concern.

CU boards also need to respond to risks being described in the news. For example, when the housing crisis hit in 2008, credit unions evaluated credit risk and concentration risk in their loan portfolios. In the last 18 months, they have had to consider the risks of retailer data breaches.

“Larger breaches like Target have raised questions regarding retail responsibility and the need for a national standard,” Bruflat says. “The breach also raised awareness of how a company’s vendors may expose it to additional data loss. It is no surprise that that has shifted the conversation toward protecting member information. The number of breaches has only increased ... and this will continue to be at the forefront of risk discussions boards are having.”

A developing risk is the coming home equity line of credit “reset” (cues.org/heloc reset), according to David Whitin, VP/analytics consulting for CUES Supplier member Equifax Inc. (www.equifax.com), Atlanta. In the next few years, a large number of HELOCs will exit their 10-year, interest-only payment period, and switch to a larger payment that includes both principal and interest.

“CUs may have members with HELOCs that have been in interest-only payment and are nearing end of draw, which will mean a large increase in payment,” Whitin says. “If a CU member has a HELOC with another lender that is getting ready to reset, the payment shock very likely could impact the member’s relationships with the CU.

“Credit unions can be made aware of changes like a payment reset through regular monitoring of the members. By understanding their members’ complete borrowing picture, CUs can better manage their risk and better service their members who could be experiencing financial difficulty.”

A risk Hui feels is most prominent today concerns information security—and he admits there’s no magic solution. Therefore, it’s important to have a plan in place if something happens.

For example, if someone breaks in and steals all the members’ debit card numbers, a credit union should know in advance if it is going to reissue all debit cards that day, or do a more detailed analysis to determine the full breadth of the breach and maybe only reissue a small percentage.

“Things can happen, because there are a lot of smart people who can get into your data if they want to,” he says. “You need to think through and make sure you have the right governance and escalation processes associated with information security if there is a
breach—both at management level and board level—for if and when it occurs.”

Brown notes that as the shift to using EMV “chip” cards picks up steam, fraud will not go away; it will just change. And boards and management teams can take solid action to address it.

“A risk assessment is a great start to understanding vulnerabilities and communicating the level of residual risk in the context of the risk appetite,” she says.

“Action items can be small operational tasks or large organizational initiatives. Regardless, a risk assessment tool aligns board and management priorities with business planning.”

It’s no surprise that as CUs become more complex, so do the threats.

“Many have tackled new business lines to diversify, and lack the experience to understand the threats” for these new undertakings, Brown says. “One of the greatest strategic threats to credit unions is to remain relevant and adaptable to the demands of the consumer. This takes collaboration amongst the CU industry and all hands on deck.”

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Resources

Vincent Hui wrote an article for boards about the risks associated with capital at cues.org/0215more. Hui is senior director with Cornerstone Advisors, CUES strategic provider of enterprise risk management services. See cues.org/cornerstone for more information.

Regulatory examiners expect board members to understand specific activities in which their credit union engages, as well as the associated risks, and risks that could lead to financial loss. Are you prepared? It’s not too late to register for Director Risk and Compliance Seminar (cues.org/drcs), slated for Sept. 14-15 in Savannah, Ga.

Read an article by Director Risk and Compliance Seminar co-presenter John DeLoach “Skeptical—No Strengthening” about questions boards should be asking their executives at cues.org/0814skeptical.